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Israel Hopes Lower Taxes, Less Regulation Extend Trading Boom

By Matthew Kalman

Israel's government could help sustain a rebound in the Tel Aviv Stock Exchange by reducing red tape and aligning taxes on capital gains with taxes on other investments like real estate, the head of the exchange told foreign reporters.

"It's very obvious to me at the moment there is not enough international money within the exchange. It's a huge potential," Ittai Ben-Zeev, its chief executive officer, said Feb. 5.

Snapshot

- Stock Exchange CEO says tax relief will help build on best year in a decade
- Exchange hopes to attract more foreign investment in local IPOs

Ben-Zeev's first year at the helm of the stock exchange coincided with a sharp upturn in trading volumes and initial public offerings as Israel's sole public exchange voted to demutualize ahead of its own 2019 IPO. There were 17 public equity offerings and three dual listings in 2017, compared to just three IPOs the previous year, while daily trading volume grew to $390 million from $330 million in 2016, and the number of listed companies increased for the first time since 2008.

"These numbers are very low compared to our potential and where we are targeting, because Israel has great potential with many startups and many companies," Ben-Zeev said. He expects daily volume to almost triple over the next two years to more than $1 billion, underpinned by the planned $4.3 billion privatization of up to 15 government-owned companies by 2020.

'Come Home'

Ben-Zeev hopes to persuade many of the 90 Israeli companies currently listing abroad to "come home" and dual-list in Tel Aviv, and encourage new companies to hold their IPOs in the local market. He must also cajole a reluctant Israeli public to invest in their local bourse.

"Certain things should be done in order to bring the Israeli public into the exchange, but obviously it's not something that we control," he said. "We have a 25 percent tax on capital gains, which is higher when you compare it to taxes on real estate in Israel. We believe that if this tax will be lower, it will bring the Israeli public into the exchange rather than investing in all kinds of other stuff."

In addition, Israel imposes a 3 percent surtax on total yearly income above 640,000 shekels ($183,000) "Many people don't see 25 percent, they see 28 percent," he said.

While foreigners are generally exempt from capital gains tax, the Tel Aviv Stock exchange hasn't been attractive target for foreign investors, even as they pour money into Israel's burgeoning high-tech venture funds, which enjoy numerous tax exemptions and accounted for $814 million out of a record $5.24 billion invested in Israel's high-tech companies in 2017, according to the IVC Research Center.

"There is a very favorable tax rate for foreign investors. As of 2011 any foreign investor that invests in a Israeli entity while he's selling his shares is entitled to an exemption on the capital gain," said Harel Perlmutter, a tax partner at Barnea, Jaffa, Lande and Co. law firm in Tel Aviv. An Israeli investor holding more than 10 percent of a company will pay 30 percent on the capital gain, plus a possible 3 percent surtax for those earning more than 640,000 shekels annually.

Witholding on Dividends

A major obstacle to foreign investment in Israeli equities is a withholding tax on dividends that can only be reclaimed by foreigners from a tax treaty country, and then only after fulfilling sometimes onerous bureaucratic conditions, said Nitzan Sandor, a capital markets partner at FBC and Co. law firm in Tel Aviv, who recently was responsible for an Israeli IPO specifically structured to attract foreign investors.

“The current 25 percent rate for withholding tax on dividends makes investments in Israeli shares often less attractive for non-Israeli investors,” Sandor said in a Feb. 6 interview. “Reducing the tax rate is a very important factor.”

Israeli IPOs are generally conducted as Dutch auctions instead of the book-building process more common abroad, and most filings are in Hebrew, creating more obstacles to foreign investors, Sandor said.

‘People Like to See Certainty’

Another issue raised by foreign investors is over-regulation, that in some areas—including the gas industry, communications sector and the finance sector—has been changing frequently in recent years.

“The State of Israel has gone too far,” Ben-Zeev said. “There is too much regulation. I think it affected foreign investments. People like to see certainty. They like to see clear visibility. When people see too many changes, they fall back.”

Two years ago, Zvi Gabbay, a former head of enforcement at the Israel Securities Authority, filed an application for a foreign company to join the Tel Aviv Stock Exchange and was surprised the rules had changed and it would not be allowed to join the main index.

“What's our biggest problem? It's legal and regulatory uncertainty. Israel has a track record of changing the rules in the middle of the game,” Gabbay, head of the capital markets department at Barnea in Tel Aviv, said Feb. 6. “The Israel Securities Authority and TASE need to place regulatory certainty on a pedestal.”

The Tel Aviv Stock Exchange is planning to encourage more dual listing and co-location services to help companies, and introduce a digital trading platform so foreigners can invest directly and cheaply online. But even if tax benefits are increased and the regulations simplified and stabilized, it's not certain the exchange will succeed in wooing the young Israeli companies it wants.

“Quite frankly, at this point I don't see any positive differentiation and this is usually the reason why companies will go outside of Israel to do their public offering, “said Tal Slobodkin, managing partner at StageOne Ventures VC firm in Herzliya, who Ben-Zeev invited to the exchange with other investors to discuss the reforms. “It's just not interesting enough.”

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